D.T.E. 00-40 Exhibit WM-5

LEGAL MEMORANDUM

WMECO IS ELIGIBLE TO SECURITIZE WHILE THE DIVESTITURE OF ITS MILLSTONE NUCLEAR ASSETS IS PENDING

I. INTRODUCTION

In the Department of Telecommunications and Energy's ("Department") September 17, 1999 decision in D.T.E. 97-120 ("Order"), the Department recognized that the Western Massachusetts Electric Company's ("WMECO" or "Company") nuclear transition costs are recoverable in the transition charge (pp. 21-32, 47-49). In its securitization petition ("Petition") filed today, WMECO proposes to issue rate reduction bonds ("RRB") to securitize, among other costs, a portion of the net book cost of its Millstone nuclear unit 2 and 3 generation assets.(1)

This legal memorandum accompanies and supports the Petition. It sets forth the reasons securitization of a portion of nuclear transition costs before their divestiture as proposed by WMECO in the Petition is authorized by, and consistent with, the Massachusetts Electric Industry Restructuring Act (Chapter 164 of the Acts of 1997) ("Act") and contributes to enhanced ratepayer savings. As explained in the prefiled testimony of Richard A. Soderman ("Soderman Testimony"), WMECO's request reflects securitization of appropriate levels of the buyouts/buydowns of purchased power contracts, generation-related regulatory assets, and its remaining nuclear investment.(2)

WMECO believes that its securitization request related to nuclear assets can and should proceed now.

II. THE DEPARTMENT CAN, AS A MATTER OF LAW, AND SHOULD, AS A MATTER OF SOUND PUBLIC POLICY, ALLOW WMECO TO SECURITIZE TRANSITION COSTS RELATED TO ITS NUCLEAR ASSETS, AS PROPOSED BY THE COMPANY, WITHOUT DIVESTITURE OF THOSE ASSETS.

In drafting the Act, the Legislature was well aware that a great majority of the transition costs that would ultimately be eligible for securitization related to nuclear plant investment. Yet, there is no requirement in the Act that nuclear assets be divested - let alone a requirement that they be divested prior to securitization.

That fact alone is ample legal support for WMECO's position. However, there is abundant contextual support for WMECO's position elsewhere in the Act as well. For example, the Act expressly recognizes that securitization is an appropriate mechanism for an electric company to use to achieve the 15 percent rate reduction required by September 1, 1999 (see § 1B(b)) (total rate reduction, including net savings from securitization, shall be 15 percent). It would have made no sense for the Legislature to have offered electric companies the use of securitization as a means for achieving this 15 percent rate reduction if it had intended that no securitization of the great majority of existing transition costs (those relating to nuclear plant investment) would be available for securitization prior to nuclear divestiture - something the Legislature was not even requiring in the first place.

This argument, as well as additional contextual support for WMECO's position, is set forth in more detail below.

The Act Contemplated The Possibility, And Indeed The Likelihood, That Nuclear Assets Would Not Be Divested When It Provided For Recovery Of Transition Costs Related To Nuclear Assets.

"Securitization" is defined in the Act as "the use of rate reduction bonds to refinance debt and equity associated with transition costs pursuant to section 1H." G. L. c. 164, § 1. The Act includes as eligible transition costs "unrecovered fixed costs . . . for generation-related assets and obligations . . . that become uneconomic as a result of the creation of a competitive generation market." G. L. c. 164, § 1G(b)(1)(i). The Act further specifies that nuclear entitlements and post-shutdown and decommissioning costs are eligible transition costs for "those electric companies which have divested their non-nuclear generation facilities." G. L. c. 164, § 1G(b)(1)(ii). No where does the Act require the divestiture of nuclear assets. In fact, the Act contemplates that the utility even retain such nuclear assets in a functionally separate entity. G. L. c. 1A(b)(1).

The most reasonable interpretation of the Act's specification of non-nuclear assets as subject to divestiture and its non-committal treatment of divestiture of nuclear assets is that the Legislature at the time of enactment viewed nuclear divestiture as unnecessary. See Commonwealth v. Galvin, 388 Mass. 326, 330 (1983) ("where the Legislature has employed specific language in one paragraph, but not in another, the language should not be implied where it is not present."). The provisions of G. L. c. 164, § 1A (setting out requirements and conditions for each of three scenarios for disposition of non-nuclear assets - divestiture, affiliate transfer or retention) lead to the same conclusion: nuclear divestiture is not required by the Act before nuclear stranded costs may be approved as transition costs and securitized. See, also, G. L. c. 164, § 1G(4)(d)(1) (requiring divestiture of non-nuclear assets, but not nuclear assets, as mitigation of transition costs). The Act, therefore, expressly provides for recovery as transition costs of uneconomic stranded nuclear assets without their divestiture. Once these costs become approved transition costs, they are eligible for securitization under c. 164, §1 G(b)(1)(i).

Because Nuclear Divestiture Was Unnecessary, The Act Permits The Department To Proceed With Securitization Of Nuclear Related Transition Costs Prior To The Divestiture Of Those Assets.

There is no question that the Act permits securitization of nuclear related transition costs and that it does not anywhere expressly require divestiture of nuclear assets. The question, then, is whether the sale of nuclear assets must be completed before the company may securitize these costs in order to satisfy the Act's requirement that the Company "fully mitigate." The answer to that question is no; a contrary result would defeat the language and purpose of the Act.

First, the Act provides that securitization is an essential part of mitigation. See, G.L. c. 164, § 1 (Definition of 'Mitigation' includes "any allowed refinancing of stranded costs or other debt obligations as provided by law"). Thus, securitization is a form of mitigation itself as an "effective mechanism for reducing identifiable transition costs." See § 1G(d)(1)(vi).

Second, the Act expressly requires divestiture of non-nuclear assets prior to securitization; it does not require divestiture of nuclear assets. Thus, the language of the Act itself differentiates between the treatment of nuclear and non-nuclear assets. At the same time, the Act requires full mitigation of the associated costs of both. Applying the plain language of the statute, WMECO may securitize the costs related to its nuclear assets so long as WMECO has fully mitigated those costs. Full mitigation means that WMECO has established a mechanism which extracts from the asset, for the benefit of ratepayers, all residual value in

the asset. With respect to its nuclear assets, for which divestiture is not required, WMECO has done this with its nuclear performance-based ratemaking plan ("PBR"). In WMECO's Restructuring Order, the Department approved WMECO's PBR which sets the nuclear going-forward recoverable costs at an average peer group level and includes a capacity factor benchmark at the industry 2nd quartile. Valuation of the Company's PBR is estimated to offset transition costs by $18.5 million for 2000 and 2001. See, Soderman Testimony. Thus, because WMECO established a mechanism that extracts from these assets all residual value, it has fully mitigated them.

Indeed, WMECO's PBR must constitute full mitigation. In the absence of a divestiture requirement, where the asset must be operated to realize value, it would not make sense to define "full mitigation" as the completion of the recovery of all value from the asset. Under that definition mitigation would not be complete for decades, until all of the nuclear units reached the end of their useful lives and were closed. Given that the great majority of transition costs relate to nuclear assets, it is inconceivable that the Legislature intended that nuclear assets be ineligible for securitization until the end of the useful lives.

The Act's reconciliation provision adds further support to the proposition that WMECO's approved PBR constitutes full mitigation. The Act addressed the need to securitize transition costs before they are precisely determined by providing for subsequent reconciliation. Once transition costs are securitized and become by statutory definition "reimbursable transition costs amounts" authorized in a financing order by the Department, they are subject to review and the Company's rates continue to be subject to adjustment on account of differences between "the amount of reimbursable transition costs amounts previously included in a financing order" and "the correct amount of the reimbursable transition costs amounts[.]". See, G. L. c. 164, § 1G(a)(2). The Department has already established a precedent that, should actual transition costs as finally determined prove lower than the securitized amount of such costs, as previously estimated, the Department may order establishment of a residual value credit in a transition cost reconciliation proceeding. See, Boston Edison Company, D.T.E. 98-118, p. 26-27 (addressing securitization of estimated financing costs). This mechanism would be unnecessary if no securitization could occur until after the final results of all mitigation-related actions are known.

The Act's Provisions Pertaining To Securitization of Nuclear-Related Transition Costs Should Be Interpreted And Applied To Carry Out The

Act's Central Purpose: To Reduce Rates For Consumers.

As shown above, as a legal matter, the Act authorizes securitization of estimated nuclear-related transition costs, provided that such estimated transition costs have been approved by the Department, fully mitigated, and the Company has divested its non-nuclear assets. Thus, as a legal matter the Department can permit WMECO to securitize these costs now. The Department also should do so as a matter of sound public policy. Permitting WMECO to securitize these costs is consistent with, and indeed furthers, the Act's central purpose - to reduce consumer electricity rates - because it enables ratepayers to take fullest advantage of the savings created by securitization.

The preamble to the Act clearly sets out the purpose of the Act's securitization provisions:

The initial benefit of this transition to a competitive market shall result in consumer electricity rate reductions of at least 10 per cent beginning on March 1, 1998, as part of an aggregate rate reduction totaling at least 15 per cent upon the subsequent approval of divestiture and securitization.

This purpose - to allow for further rate reduction - is reaffirmed in G. L. c. 164, §1B(b), quoted above, in § 1G(c)(2) (authorizing distribution companies to attain additional rate reduction through the use of securitization) and in requirements for

the Company's Petition and for the findings to be made by the Department before approving such application:

The electric company shall in its [securitization] application specify that its customers would benefit from reduced electricity rates through the issuance of electric rate reduction bonds. The department shall determine reimbursable transition costs amounts recoverable in one or more financing orders if the department determines, as part of its findings in connection with the financing order, that the designation of the reimbursable transition costs amounts and the issuance of electric rate reduction bonds by the financing entity in connection with some or all of the reimbursable transition costs amounts would reduce rates that an electric company's customers would have paid if the financing order were not adopted, and that such rates will be reduced in aggregate amounts equal to savings realized by the electric company with respect to the order.

G. L. c. 164, § 1H(b)(2).

There can be no question that a construction of the Act that allows the largest amount of transition costs to be securitized, consistent with financial prudence, including reasonable estimated nuclear-related transition costs, fulfills the Act's intent. Thus, denying the Company the opportunity to securitize any of its nuclear-related transition costs and thereby reducing the savings that are available to support rate reduction defeats the stated purpose of the securitization provisions of the Act, and cannot properly express the Legislature's intent.

The Department In Its Sound Discretion Should Approve WMECO's Proposed

Securitization Because WMECO Has Met The Act's Requirements For Securitization Of Its Nuclear-Related Transition Costs.

As explained below, WMECO has met all of the Act's requirements for securitization. The Department, therefore, should approve WMECO's petition.

In order for the Department to approve securitization of eligible transition costs, the Department must have approved the Company's Restructuring Plan. G. L. c. 164, § 1A(a). The Company also must show that its securitization proposal meets several criteria: 1) a plan calling for full mitigation of transition costs, including divestiture of non-nuclear assets; 2) savings to ratepayers; 3) all savings that result from securitization will inure to the benefit of ratepayers; 4) non-managerial employees will be protected in any asset divestitures; and 5) a demonstrated order of preference for the use of the bond proceeds. G. L. c. 164, § 1G(d)(4). Mitigation includes the use of "refinancings of stranded assets or other debt obligations as provided by law." G. L. c. 164, § 1. In addition, the Company must have reached agreements for payment in lieu of taxes with any Massachusetts municipalities where it owned as of July 1, 1997 nuclear generation facilities. G.L. c. 59, § 38H(c). See, also, Boston Edison Company, D.T.E. 98-118 (April 2, 1999), pp. 5-6.

The Department has approved WMECO's restructuring plan. In its Order, the Department approved WMECO's restructuring plan subject to a compliance filing. On December 20, 1999, the Department issued an Order on the Company's compliance filing with respect to its distribution rates and transition costs. Western Massachusetts Electric Company, D.T.E. 97-120-B, Order on Compliance Filing (1999). Subsequently, the Department approved other aspects of WMECO's restructuring plan. On December 30, 1999, the Department issued an Order approving the Company's standard offer solicitations. Western Massachusetts Electric Company, D.T.E. 97-120-D, Order on Standard Offer Compliance Filings (1999). Finally, on January 5, 2000, the Department approved tariffs for service on and after January 1, 2000 submitted by

the Company as consistent with the above-referenced orders.

The other criteria that need to be met in order to qualify for securitization (ratepayer savings, savings will inure to ratepayers, non-managerial employees will be protected in asset divestitures, and a demonstrated order of preference for use of the bond proceeds), are demonstrated in WMECO's accompanying Petition and testimony. (WMECO has no nuclear generation facilities in Massachusetts and therefore the tax agreement requirement is not applicable.) Thus, for all reasons set forth herein, the Department should approve the Company's securitization petition.

IV. CONCLUSION

For the reasons set forth above, WMECO's request for securitization of the transition costs related to its nuclear assets as set forth in its Petition complies with the Act, maximizes consumer savings and should be allowed.

Respectfully submitted,

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1. 1 WMECO has completed the sale of its non-nuclear generation assets and is in the process of divesting its Millstone assets. However, it is not anticipated that any sale of its Millstone assets would be final until 2001.

2. 2 By limiting its nuclear securitization request to a certain percent, WMECO provides sufficient cushion to absorb any current or future mitigation or market valuation offset for these facilities when sold, yet permits immediate securitization as called for under the Act to facilitate the rate reduction of 15 percent implemented on September 1, 1999. G. L. c.1B(a) and 1G(c)(2). While WMECO is not required to value its nuclear assets under § 1A(c) because that section is applicable only to electric companies who chose not to sell existing non-nuclear generation facilities, an administrative valuation has been performed by the Connecticut Department of Public Utility Control ("DPUC") for the Millstone assets pursuant to the Connecticut Restructuring Act. WMECO's request here is consistent with the DPUC's valuation. See the pre-filed testimony of Richard A. Soderman.